

The State of Illinois taxes leases differently for Retailers' Occupation Tax and Use Tax purposes than the majority of other states. See 86 Ill. Adm. Code 130.220. (This is a GIL.)

September 21, 2001

Dear Xxxxx:

This letter is in response to your letter dated August 16, 2001 and our telephone conversation on September 10, 2001. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found at <http://www.revenue.state.il.us/legalinformation/regs/part1200>.

In your letter, you have stated and made inquiry as follows:

We respectfully request your assistance with our request for a general information letter regarding the following fact pattern and issues. We also request that all company-specific information provided be maintained confidential and that any release of this ruling request be sanitized.

Fact Pattern

AAA is in the business of purchasing inventory items (i.e. clothing) for use in wholesale, retail, and rental operations. AAA's business activities can best be segregated as follows:

Wholesale Customer Activities (90% of revenues) -- products are purchased by AAA for immediate rental to non-affiliated third-party retail/rental companies who subsequently re-rent the products to their customers and collect applicable sales tax. These transactions occur in multiple states. AAA obtains resale exemption certificates from all applicable non-Illinois retail/rental companies. Of those states in which AAA operates, Illinois is the only state that requires a sales or use tax to be paid, at the point of purchase, on items for subsequent rental. With very few exceptions, all other states require that a sales tax be collected on each individual *retail* rental transaction.

Retail & Rental Activities (10% of revenues) -- products are purchased for resale or rental by AAA's self-owned business locations. AAA maintains self-owned locations in STATE and Illinois. AAA collects sales tax from STATE rental customers. A consumer's use tax has been paid on all Illinois rental inventory items.

In addition to their STATE and Illinois retail/rental locations, AAA also has warehouse distribution locations in multiple states. Upon purchase, inventory is shipped to the

applicable warehouse distribution location by the vendor. The inventory is used to service a specific area that can cover several states surrounding the warehouse location. Due to clothing style changes and wear, AAA's product inventory has a minimal useful life. Wholesale inventory can be utilized by various rental companies, throughout multiple states, during its useful life. Following each rental transaction by one of AAA's wholesale customers, the rental items are returned to the applicable warehouse to be laundered and maintained for redistribution. AAA has two warehouse distribution locations in Illinois. The Illinois warehouse locations primarily service non-affiliated third-party retail companies:

CITY1, Illinois Warehouse --has serviced 6 states (including Illinois)
 CITY2, Illinois Warehouse --has serviced 32 states (including Illinois)

AAA purchases all inventory from non-Illinois vendors. An Illinois use tax has been self-remitted on all shipments to the Illinois warehouse locations.

AAA maintains detailed revenue transaction data regarding the wholesale and retail rental activity occurring within each state. There is no business purpose that requires AAA to track revenue activity per state for each individual clothing item. Revenue data can best be summarized as follows for the years 1996 through 2000:

CITY1, Illinois Warehouse Distribution Location:
 % Revenues Generated from Rental Activities

	Illinois	Non-Illinois
1996	56.56%	43.44%
1997	57.24%	42.76%
1998	51.95%	48.05%
1999	52.40%	47.60%
2000	50.70%	49.30%

CITY2, Illinois Warehouse Distribution Location:
 % Revenues Generated from Rental Activities

	Illinois	Non-Illinois
1996	37.64%	62.36%
1997	34.88%	65.12%
1998	34.52%	65.48%
1999	32.76%	67.24%
2000	31.22%	68.78%

Issue:

AAA respectfully requests that the state of Illinois consider and address the following proposed Illinois use tax reporting structures.

Assumption #1:

AAA currently instructs its vendors (all non-Illinois) to ship inventory products separately, as ordered, to each warehouse distribution location. On the basis of AAA's detailed transaction record-keeping capabilities, would it be acceptable by the state of Illinois for AAA to self-remit a use tax on the percentage of purchase transactions correlating with Illinois rental revenue calculations? For audit purposes, AAA would maintain transaction support for Illinois v. non-Illinois rental activities, as well as, resale exemption documentation for applicable non-Illinois activities.

Assumption #2:

AAA is in consideration of consolidating its purchasing activities. In the event this business structure is pursued, AAA would instruct its vendors (all non-Illinois) to ship all inventory products to a centralized AAA location. The products would then be distributed to the applicable warehouse location. If a centralized warehouse location is implemented, it will not be located in the state of Illinois due to immediate distribution needs. On the basis of AAA's detailed transaction record-keeping capabilities, would it be acceptable by the state of Illinois for AAA to self-remit a use tax on the percentage of purchase transactions correlating with Illinois rental revenues? For audit purposes, AAA would maintain transaction support for Illinois v. non-Illinois rental activities, as well as, resale exemption documentation for applicable non-Illinois activities.

It is currently difficult for AAA to maintain the proper level of competition in regard to non-Illinois transactions. As is, the product cost factor for non-Illinois transactions, includes an Illinois use tax, which is subsequently taxed by non-Illinois retailers when applying a sales tax to their transactions.

We appreciate your consideration of our proposals. Please do not hesitate to contact me with additional questions.

DEPARTMENT'S RESPONSE:

Please note that the State of Illinois taxes leases differently for Retailers' Occupation Tax and Use Tax purposes than the majority of other states. For Illinois sales tax purposes, there are two types of leasing situations: conditional sales and true leases.

A conditional sale is usually characterized by a nominal or one dollar purchase option at the close of the lease term. Stated otherwise, if lessors are guaranteed at the time of the lease that the leased property will be sold, this transaction is considered to be a conditional sale at the outset of the transaction, thus making all receipts subject to Retailers' Occupation Tax.

A true lease generally has no buy out provision at the close of the lease. If a buy out provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease. Lessors of tangible personal property under true leases in Illinois are deemed end users of the property to be leased. See the enclosed copy of 86 Ill. Adm. Code 130.220. As end users of tangible personal property located in Illinois, lessors owe Use Tax on their cost price of such property. The State of Illinois imposes no tax on rental receipts. Consequently, lessees incur no tax liability.

The above guidelines are applicable to all true leases of tangible personal property in Illinois except for automobiles leased under terms of one year or less, which are subject to the Automobile Renting Occupation and Use Tax found at 35 ILCS 155/1 et seq.

As stated above, in the case of a true lease, the lessors of the property being used in Illinois would be the parties with Use Tax obligations. The lessors would either pay their suppliers, if their suppliers were registered to collect Use Tax, or would self-assess and remit the tax to the Department. If the lessors already paid taxes in another state with respect to the acquisition of the tangible personal property, they would be exempt from Use Tax to the extent of the amount of such tax properly due and paid in such other state. See 86 Ill. Adm. Code 150.310(a)(3) enclosed.

Under Illinois law, lessors may not "pass through" their tax obligation on to the lessees as taxes. However, lessors and lessees may make private contractual arrangements for a reimbursement of the tax to be paid by the lessees. If lessors and lessees have made private agreements where lessees agree to reimburse lessors for the amount of the tax paid, then lessees are obligated to fulfill the terms of the private contractual agreements.

In regards to your Assumption #1, you are making the assumption that the items that are held in inventory for rental in Illinois are not subject to Use Tax liability if the rental of those items occurs outside of this State. Under the Use Tax Act, a tax is imposed upon the privilege of using in Illinois tangible personal property purchased at retail from a retailer. See the enclosed copy of 86 Ill. Adm. Code 150.101. "Use" is defined as the "exercise by any person of any right or power over tangible personal property incident to the ownership of that property." See the enclosed copy of 86 Ill. Adm. Code 150.201.

You stated in your letter that the entire inventory is purchased from non-Illinois vendors, but that the rental items are returned to the applicable warehouse to be laundered and maintained for distribution. Subsection (a)(4) of Section 150.310 of the Department's administrative rules describes the temporary storage exemption for tangible personal property purchased outside of this State. The tax shall not apply to "the temporary storage, in this State, of tangible personal property which is acquired outside this State and which, subsequent to being brought into this State and stored here temporarily, is used solely outside this State or is physically attached to or incorporated into other tangible personal property that is used solely outside this State, or is altered by converting, fabricating, manufacturing, printing, processing or shaping, and, as altered, is used solely outside this State." See subsection (a)(4) of the enclosed copy of 86 Ill. Adm. Code 150.310. Since the rental items are returned to the applicable warehouse to be laundered and maintained for distribution for subsequent out-of-State or in-State rental, the temporary storage exemption is not available because those items may be not used entirely outside of this State.

Illinois also provides an interim use exemption as described in subsection (a) of the enclosed copy of 86 Ill. Adm. Code 150.306. The pertinent provisions of this Section state:

"[T]he leasing of tangible personal property by persons who are primarily engaged in the business of selling such property at retail is within the interim use exemption if such property is carried as inventory on the books of the retailer or is otherwise available for sale during the lease period. Except as to motor vehicles described in subsection (a)(4), the interim use exemption is not available to persons who purchase tangible personal property with the intent to engage in the business of leasing such property and who sell such property only as an incident to their leasing activity."

Unless your business is considered to be primarily (over 50%) engaged in the business of selling such property at retail and that property is carried as inventory on the books and records of the retailer (or is otherwise available for sale during the lease period), then it cannot claim the interim use exemption.

In reference to your Assumption #2, if the warehouse was not located in this State and all inventory is from non-Illinois vendors, then only the items that are rented in this State will be subject to Illinois Use Tax liability. As we had discussed by telephone, our office cannot approve the method for determining your business's proper Use Tax liability based upon a percentage of rental revenues relating to Illinois rentals. However, the Department has allowed taxpayers to use somewhat similar formulas in special situations. Those special situations involve lessors who have recurring liabilities on numerous rental items in Illinois as well as other states, and where such items are constantly moving back and forth among the states. Persons seeking authorization to use such formulas should contact the Department's Audit Bureau. Please send such requests to Manager, Audit Bureau, 3-310, Illinois Department of Revenue, 101 West Jefferson, Springfield, Illinois 62794.

I hope this information is helpful. The Department of Revenue maintains a website, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b) described above.

Very truly yours,

Terry D. Charlton
Associate Counsel

TDC:msk
Enc.